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ALTERNATIVE DISPUTE RESOLUTION SYMPOSIUM

Investor-state arbitration: rationale and legitimacy

JOHN DOE* — 6 July, 2016

A reply to Christian Tietje

Attempts to conceptualize the foundations of and crucial questions around investment arbitration are most welcome, as the field gains not only public attention, but also increasing importance for investors as well as receivers. Christian Tietje, claiming in the title that investor-state arbitration is a part of the international rule of law and, therefore, a mechanism for upholding it, touches on what may surely be called a heated topic. Especially, as public and scholarly debate tends to be rather political in nature and especially, when authors, journalists, scholars and politicians take a rather critical stance. Indeed, the complexity of the issues surrounding investment arbitration (IA) and more

specifically Investor-State Dispute Settlement (ISDS) are often not treated in sufficient depth to allow for informed assessments of their nature and consequences. Contrarily, controversies related to IA are not entirely new, as NAFTA and its investment-protection mechanism has sparked such debates for a number of years already, well beyond narrow circles of experts and people directly involved [see here and here]. Therefore, there might be value in pointing out that criticism has been there for quite some time and is much more nuanced than the author suggests. I would like to emphasize some of these issues, following the main approach chosen by Tietje by dividing the understanding of ISDS in its rationale and legitimacy.

The rationale of ISDS

In terms of the *rationale*, the differentiation between domestic and foreign citizens and entities – potentially leading to discriminatory treatment – is undoubtedly a strong reason for the existence of investment protection-mechanisms based on treaties between states, and, therefore, international law. This notion may be looked at in some more detail, which provides some additional insight into the rationale: First, the differentiation between in- and outsiders concerning the application of domestic law is a basic concept of the "westphalian" nation-state. Discriminatory treatment (or, to use a positive terminology: preferential treatment for nationals) resulting from this is not at all unusual, but to a large extent reflects the legal and political normality. Especially in economic and trade law, the granting and commitment of non-discrimination is used as a specific political and legal tool to promote trade and improve and stabilize the conditions for economic exchanges and enhancing legal certainty for all participants – usually while

reserving generous amounts of regulatory flexibility (sometimes referred to as "water") between the commitments taken in international agreements and the actual regulatory situation (e.g. applied rules on transparency or actually applied capital caps or tariffs). Concerning investment, it is important to note that domestic and foreign investment are crucially different in that the second usually originates from economically stronger countries able to achieve the necessary surplus. This means that the normative concept of "*leveling of the playing field*" as suggested by Tietje is problematic, as – while it might reflect a situation which may be achieved e.g. between relatively well diversified and stable economies within the European common market – it implies an equality between actors that does not exist and also goes fairly beyond the scope of most existing investment protection agreements outside areas of regional integration [see here].

Second, the legal fiction of "*juridical persons*" which enjoy a certain amount of rights natural persons have within a legal system also originates in decisions of economic policy. As a concept, it is a utilitarian vehicle aimed at protecting the rights of people – natural persons – who act behind an entity like a company, limiting their liability. This makes a lot of sense in specific cases, but also needs to be regularly justified [see here]. While less disputed in economic law, where the legal forms of organization limiting risk are normal, these questions are, as Tietje points out, prevalent in legal fields which originate in the idea of conferring certain rights to human beings and protecting them.

The concept of "*legal gap*" articulated by Tietje is indeed valid to describe areas of uncertainty on the interface between domestic and international protection of rights and does to

some extent constitute the rationale for ISDS. The actual breadth or extent of this gap, on the other hand, depends on the specifics of the regulatory environment we look at. Where natural and legal persons are seen as basically identical or at least very similar legal subjects in specific contexts, foreign legal persons may appear as being denied certain rights compared to the domestically established. This again may legitimate the establishment of a positive right to investment protection and ISDS as suggested by Tietje. It is very important to add – and even more important given the geographical expansion of global investment operations – that the inclusion of juridical persons into the scope of international human rights instruments remains and is probable to remain the global exception [see here]. The claim that arbitration, and specifically investment arbitration, constitutes an "*exercise of individual freedom*" in the sense of a basic (human) right is at the moment limited to developments in certain jurisdictions (namely European ones) and quite far away from being a universal concept.

All this said, the cited case of Tabbane v. Switzerland (41069/12, judgment of 24 March 2016) is very interesting: First, the Court did see arbitration procedures as alone fulfilling the criteria of the right to a fair trial enshrined in Art. 6(1) of the European Convention on Human Rights. But this, as the European Court of Human Rights (ECtHR) states, is only the case under very specific conditions: the agreement to wave the possibility of having recourse through domestic courts must be *fairly made, licit and unequivocal*. An imbalance between parties, which in many cases enables one to impose terms on the other, is well recognized to influence such conditions negatively: As an example, the Oberlandesgericht (OLG) Munich questioned the legality of the Court of arbitration for sport (CAS) Lausanne as

mentioned by Tietje. Also, – as an analogy – the Swiss Supreme Court found in Cañas (Decision of Swiss Supreme Court of 22 March 2007, 133 III 235) held, that athletes are not bound by waivers of recourse against awards, even if they satisfy the formal requirements of the federal law allowing for such waivers. The Swiss Supreme Court's reasoning was that such a waiver cannot be deemed to have been freely made, given the obvious imbalances between the parties. The Swiss Federal Court as well as the ECtHR do recognize, that arbitration is only constituting a "*fair trial*" in human rights in the narrower sense of the word, when the circumstances surrounding the decision to waive fulfil high standards. As Tietje points out, the "insurance of equal rights" for both disputing parties is crucial. But – given the possible relations of dependence between important investors and receiving countries, the transposition of the *Tabbane* decision and the principle it reflects on international investment arbitration in general and particularly including parties outside of NAFTA and the EU is difficult.

The legitimacy of ISDS

Whereas the rationale behind ISDS may be explained and understood without entering the realm of politics, the issue of *legitimacy* is much more complex. It is closely linked to a concept which is notorious for being hard to grasp and even harder to effectively use in practice: sovereignty. As investment arbitration is not the "*only enforceable means*" of investment protection as suggested – there are domestic courts and complementary instruments like private and public insurances, specific contracts with the host country and the possibility of joint ventures – there must be also other reasons for its existence.

Conclusion

The *raison d'être* of international economic and trade law is to a large extent the creation of legal certainty. In a time where the mobility of capital is comparably high, uniform and reliable rules do indeed make the life easier for international investors and also for countries seeking to attract foreign investment. ISDS creates means to cope with the relative unpredictability of political decision-making and provides some increase in reliability and legal certainty. And while it does indeed not restrict the limits of the possible for political decisions as such – in principle, the sovereign rights of any state to change its domestic legislation are not impaired – it does potentially increase the potential cost of such changes for the public. The individual-rights-dimension of ISDS, therefore, does only tell half of the story, as they will continue to be perceived through their political characteristics.

Indeed, as Tietje points out, there is room but also are real prospects for improvement in ISDS. The United Nations Commission on International Trade Law (UNCITRAL)-rules as well as the UN-convention on Transparency in treaty-based Investor-State-Arbitration (ISA) might be a step in order to provide more transparency and acceptance, if more states actually relevant for international investment-flows would ratify them. Hopefully, some of the future Free-Trade-agreement (FTA)- and investment-protection agreements (IPA)-practice will reflect suggestions made therein and move IA and ISDS out of the obscure light it is – often unjustified – put in.

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